No. 141

In the Supreme Court of the United States

October Term, 1959

Massey Motors, Inc., petitioner

v.

United States of America

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE UNITED STATES

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OPINIONS BELOW

The findings of fact and conclusions of law of the District Court (R. 105–117, 121–124) are reported at 156 F. Supp. 516. The opinion of the Court of Appeals (R. 132–144) is reported at 264 F. 2d 552.

JURISDICTION

The judgment of the Court of Appeals was entered on February 26, 1959. (R. 144.) On May 22, 1959, by order of Mr. Justice Black, the time within which to petition for a writ of certiorari was extended to and including July 13, 1959. (R. 145.) The petition was filed on June 24, 1959, and the writ was granted on October 12, 1959, 361 U.S. 810. (R. 145.)

The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254(1).

QUESTION PRESENTED

Taxpayer, an automobile dealer, withdrew from inventory certain automobiles which it bought during the calendar years 1950 and 1951. It assigned approximately one-half of these to employees for transportation in connection with the company's business. The other half it rented to an unaffiliated finance company. Taxpayer's practice was to dispose of both leased and "company" cars at the time of a model change or earlier—in all events, long before the end of their physical or economic life. All of the cars in question were sold (as used cars) for very substantial prices (in most instances, at figures in excess of taxpayer's purchase price).

The question, relating to the "reasonable" allowance for depreciation authorized by Section 23(l) of the Internal Revenue Code of 1939, is whether the "company" cars and leased automobiles are depreciable (as the Government contends) on the basis of their estimated useful life in the taxpayer's business, using a depreciation base consisting of cost less the substantial resale value of the automobiles at the end of their useful life in taxpayer's business, rather than (as taxpayer contends) on the basis of the longer physical life of the automobiles, with cost less salvage value at the end of their physical life as the depreciation base.

STATUTES AND REGULATIONS INVOLVED

Sections 23(l) and 3791(a) and (b) of the Internal Revenue Code of 1939, and Sections 29.23(l)-1, 29.23(l)-2, 29.23(l)-4 and 29.23(l)-5 of Treasury Regulations 111 are set forth in Appendix A, *infra*, pp. 12-15.

STATEMENT

In 1950 and 1951, taxpayer, a franchised Chrysler dealer, withdrew from shipments of new cars which it received fifty-one and fifty-three automobiles, respectively. Approximately one-half of these were assigned to company executives and other employees for use in connection with the company's business.[1] (R. 110-111, 121-122, 133). The other half were rented to an unaffiliated finance company at a net rental of three cents a mile, which yielded taxpayer a substantial net profit. (R. 122, 133.)

The company cars were uniformly sold at the end of 8,000 to 10,000 miles' use or upon the receipt of new models, whichever was earlier. The rental cars were sold upon 40,000 miles of use or upon receipt of new models. In nearly every instance, the company cars were sold for more than they cost taxpayer; on the average, the rental cars also brought something above original cost. (R. 111-112, 133.) Thus, the company cars in issue were sold for $11,272.80 more than their aggregate cost, and the rental cars for $525.84 more than their total cost. (R. 133.) In 1950, taxpayer sold twenty-seven of the fifty-one cars which had been withdrawn from inventory, and in

[1] We refer to these as company cars.

1951 it sold twenty-three of the cars withdrawn from inventory.[2] (R. 122.)

Taxpayer figured depreciation on all of the cars on the straight line basis, with no allowance for salvage value. Gains on the sales were computed at capital gains' rates with a basis of cost less depreciation. (R. 133.) The Commissioner disallowed capital gains treatment on the ground that the automobiles were not property used in the trade or business under Sec-

[2] The following tables, which have been adjusted for duplications and items not in issue, show the length of time the company cars and leased cars were held by taxpayer, their cost and sales price, and the depreciation claimed (Exs. 3 and 4, R. 147–150):

Company cars used and sold in 1950 and 1951

Item No.	Date purchased	Date sold	Cost price	Sales price	Total depreciation claimed
4	10-12-49	1-17-50	$1,850.94	$2,095.00	$154.41
5	10-10-49	1- 2-50	1,738.93	1,995.00	145.03
6	11- 1-49	1- 7-50	1,730.46	1,977.00	98.42
7	11- 1-49	4-14-50	1,730.47	2,085.00	192.55
9	1- 3-50	6-29-50	2,026.82	2,829.30	281.52
10	6- 5-50	10- 7-50	1,704.84	2,095.00	109.64
16	7-12-50	9- 1-50	1,836.87	2,250.00	51.17
17	7-19-50	10-30-50	1,810.36	2,493.10	100.94
18	9-11-50	11-14-50	1,956.00	2,885.15	108.78
19	5-19-50	7-31-50	1,989.50	2,485.95	110.66
22	5-25-49	4-14-50	1,409.85	1,695.00	416.69
26	6-28-49	1-19-50	2,086.43	2,695.00	347.98
28	10- 6-49	6- 8-50	1,660.61	1,819.70	369.25
30	12-21-49	7-27-50	1,864.23	2,400.00	310.93
42, 79	6- 7-50	3- 3-51	1,831.[illegible]	1,010.00	457.99
48, 58	8-17-50	2-28-51	2,18[illegible]	2,595.00	264.29
50, 60	8-30-50	2- 6-51	2,107.65	2,300.00	292.91
52, 62	10-12-50	2-12-51	1,733.88	2,010.00	144.60
54, 82	6-23-50	4-16-51	1,663.89	1,900.00	411.63
56, 83	8- 8-50	2-28-51	1,802.75	2,629.85	253.38
64	1- 9-51	6-19-51	2,247.96	2,695.00	312.22
65	1-24-51	4- 7-51	1,773.51	2,441.62	98.67
66	2-14-51	5-30-51	1,801.10	1,917.04	105.06
67	4-11-51	5-16-51	1,944.77	2,026.75	-0-
68	3-29-51	8-23-51	2,498.65	2,500.00	276.81
70	4-27-51	7- 5-51	1,950.17	1,950.17	54.57
85	2-28-51	10-26-51	2,068.13	2,872.28	391.43
Company cars used and sold			$51,175.11	$62,447.91	$6,039.35

tion 117(j) of the Internal Revenue Code of 1939, but were held primarily for sale to customers in the ordinary course of taxpayer's trade or business. He also disallowed the depreciation claimed. Taxpayer paid the resulting deficiency and thereafter filed claims for refund, asserting (R. 11) that it was "entitled to a reasonable allowance for depreciation as claimed on the aforementioned automobiles, constituting property used in its trade or business * * * and that the gain realized by it on the sale of said automobiles is reportable as long term capital gain * * *." Upon disallowance of the claims, suit for refund was filed in the District Court. The trial

(Footnote 2—Continued.)

Cars leased in 1950 and 1951

Item No.	Date purchased	Date sold	Cost price	Sales price	Total depreciation claimed
2	8-30-49	1-26-50	$1,958.02	$2,019.82	$217.86
8	12-21-49	3-27-50	1,800.74	2,495.00	103.62
11	6-17-50	7-21-50	1,450.22	2,100.00	40.30
12	6-12-50	10-25-50	1,804.00	1,977.50	210.48
13	6-15-50	6-29-50	1,475.10	1,475.10	0
14	6-7-50	10-3-50	1,475.10	1,500.00	164.06
20	4-18-49	7-1-50	1,406.37	1,250.00	586.11
21	3-31-49	2-3-50	1,451.18	1,875.00	604.67
22	4-26-49	7-14-50	1,363.12	1,565.00	500.20
24	5-24-49	6-29-50	1,637.15	1,325.00	645.95
25	6-13-49	6-14-50	1,366.56	1,495.00	455.32
27	7-19-50	7-25-50	1,800.00	1,400.00	550.00
29	11-2-49	7-6-50	1,429.60	1,452.50	317.72
38, 74	1-19-50	5-10-51	1,684.41	1,850.00	702.03
39, 75	6-2-50	5-25-51	1,476.60	1,300.00	451.35
40, 76	6-2-50	7-2-51	1,476.60	1,395.00	533.37
43, 80	6-16-50	5-30-51	1,411.02	1,200.00	481.27
44, 81	6-16-50	6-20-51	1,411.02	1,350.00	470.46
46, 77	6-7-50	9-12-51	1,475.10	1,400.00	614.73
47, 78	6-7-50	5-30-51	1,475.10	1,150.00	450.85
51, 61	10-16-50	2-23-51	1,978.32	2,105.00	219.92
69	4-20-51	7-11-51	1,119.05	1,300.00	93.41
Leased cars used and sold			$34,374.38	$34,890.92	$8,303.88
Total of company and leased cars			$85,540.40	$97,347.83	$14,433.23

court held in favor of taxpayer, ruling (1) that the cars in question were capital assets, rather than stock in trade, and (2) that the method of taking depreciation, utilizing a thirty-six-months' estimated useful life with no deduction for salvage value, was fair and reasonable. (R. 7-10, 110, 133-134.)

In the court below, the Government abandoned its contention that the property in question was ordinary stock in trade. (R. 132-133.) It pressed contentions that the depreciation must be figured with relation to the known useful life of the assets in the hands of taxpayer, rather than the entire physical life of the property; that the depreciation cannot properly be determined without considering salvage value at the end of the useful life in the hands of taxpayer; that it was demonstrated that useful life in the hands of taxpayer was less than a year; and that the salvage value was no less than original cost. (R. 134.)

The court below (one judge dissenting without opinion) sustained the Commissioner's views as to the meaning of useful life and reversed the judgment. The court also directed that there be a new trial so that the facts relating to salvage value might be more fully developed.[3]

ARGUMENT

1. The basic legal issue presented by this case—whether taxpayer is to spread depreciation over the estimated useful life of the assets in the taxpayer's

[3] The final paragraph of the Court of Appeals' opinion deals with an entirely unrelated issue not before this Court.

business or over a period measured by their expected physical life—is precisely the same issue as is presented in *Commissioner* v. *Evans,* No. 143. This issue is also involved in *Hertz Corp.* v. *United States,* No. 283. The arguments which support the Commissioner's view that useful life is to be measured by the taxpayer's holding period are elaborated in our briefs filed in the *Evans* and *Hertz* cases (copies of which are being served upon this petitioner) and, rather than repeating them here, we respectfully refer the Court to the discussion contained in those briefs.

The issue, we point out, arises here in the same context as in *Evans* (although the facts here are somewhat more dramatic). Taxpayer, as noted in the Statement, keeps cars for relatively short periods (see note 2, pp. 4–5, *supra*)—periods so short that it was able to obtain, when it sold the vehicles here involved as used cars, amounts aggregating more than the total purchase price of such cars. Nonetheless, it has assumed that it may take depreciation on the basis of the cars' physical life, which it has estimated at three years.

The practical consequences which follow from this assumption are evident. Salvage value, as taxpayer concedes,[5] is to be deducted from the base upon which

[5] In the District Court, taxpayer claimed depreciation without deducting any salvage value, and its position was sustained. (R. 134.) In the Court of Appeals, however, taxpayer conceded that salvage value must be deducted before depreciation is taken. (R. 136.) Its opening caption in the brief filed with this Court (p. 12) states in part that "salvage value, if any, is to be determined as of the end of * * * physical or economic useful life."

straight line depreciation is computed. The salvage value of a late-model automobile is obviously much greater than the salvage value of a comparable automobile several years old. Taxpayer's proposition that salvage value is to be estimated as of the end of physical life and not at the conclusion of taxpayer's holding period would enable taxpayer to ignore what we consider to be actual salvage value—the anticipated price that cars will yield at the time of anticipated sale—and to inflate the depreciation base. Depreciation deductions, of course, are offset against ordinary income, which is taxable at the rate of 52 percent. Although it is true that excessive depreciation is reflected in taxpayer's reported capital gains, capital gains are taxable only at 25 percent.

The facts of this case, as we have said, are dramatic. Taxpayer actually obtains more, when it sells company and rental cars, than its original cost. Thus, in our view, taxpayer is unable to justify deductions for depreciation in any amount: salvage value is not less than cost. Taxpayer's artificial premise—that the useful life of its cars includes their life in other taxpayers' hands—would enable it to take depreciation in circumstances where it has already recovered (or more than recovered) its costs. This, as argued in the *Evans* and *Hertz* briefs, is fundamentally inconsistent with the function that depreciation is designed to serve: "to accrue as to each classification of depreciable property an amount which at the time it is retired will with its salvage value replace the original investment therein," *Detroit Edison Co.* v. *Commissioner,* 319 U.S. 98, 101.

2. One further aspect of this case requires comment. In its petition for certiorari, taxpayer raised a single question, which it formulated as follows: "Whether petitioner, a retail automobile dealer, is entitled to utilize a 'useful life' of three years in computing depreciation with respect to certain company and rental cars used by it in the operation of its business and an estimated salvage value at the end of such three-year period in filing its Federal corporate income tax return for the calendar years 1950 and 1951." In support of its petition, it asserted a direct conflict with the decision of the Ninth Circuit in the *Evans* case and that the public interest required resolution of this conflict. Agreeing with taxpayer's statement of the question presented, the Government acquiesced in grant of the writ. Taxpayer now insists, in its brief on the merits (p. 17, *et seq.*), that this Court should not decide the question presented by the petition. It suggests that the Government raised that question for the first time on appeal to the Court of Appeals and that it was "erroneous" for that court to consider it.

As we shall point out, the question was before the District Court. If taxpayer is right, however, and the Court of Appeals should not have considered the question which taxpayer has brought here for review, the appropriate disposition would be to dismiss the writ as improvidently granted. Certainly, the question whether the Court of Appeals made a proper appraisal, in a particular case, as to the scope of the issues litigated by the parties in the District Court is not one which has any claim to general importance.

And, in any event, that is not the question which the Court, on taxpayer's petition, decided to review.

Taxpayer's administrative claims for refund put in issue two distinct questions: (1) whether it was entitled to treat gains on the automobiles involved as capital gains (a question which turned on whether the automobiles were held primarily for sale to customers in the ordinary course of business and one which is no longer in the case); (2) whether its deductions for depreciation should have been disallowed. (R. 7–11.) When the claims for refund were denied and taxpayer brought suit, it had the burden on both of these issues. The Government's answer, which denied that taxpayer was entitled to any refund, conceded neither. Nor was there any concession of either issue at any other stage of the trial.[4] It follows that the Government was fully entitled to contend on appeal that taxpayer had not met its burden of showing that the Commissioner had erred in disallowing the depreciation deductions. The Court of Appeals was correct in its conclusion that the issue of depreciation was "separately raised" in the District Court. (R. 134, n. 3.)

Even if the Court of Appeals' conclusion on this point were questionable (which we do not believe to be the case), the rule that appellate courts will not ordinarily consider legal issues which have not been raised below is one of general policy, not one of jurisdiction, and the policy is not "inflexible." *Hormel* v.

[4] Moreover, Government counsel, contrary to taxpayer's assertion, argued both points. See Supplemental Record on file with this Court (not printed) 30–32, 36, 44, 50.

Helvering, 312 U.S. 552, 556. Thus, it was held in the *Hormel* case that, on the Government's appeal, the Court of Appeals had power to consider a taxpayer's liability under a section of the Code which the Commissioner had not relied upon before the Board of Tax Appeals. This Court expressed itself as unwilling, in the circumstances, to permit the taxpayer "wholly to escape payment of a tax which under the record before us he clearly owes." We point out, finally, that the issue before the Court in the instant case was fully briefed and argued before the Court of Appeals, was decided on its merits by that court, and is properly here for review. Cf. *United States* v. *Bess,* 357 U.S. 51, 54–55.

CONCLUSION

The judgment of the Court of Appeals should be affirmed.

Respectfully submitted.

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APPENDIX A

Internal Revenue Code of 1939:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(l) [as amended by Sec. 121(c) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Depreciation.*—A reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—

(1) of property used in the trade or business, or

(2) of property held for the production of income.

* * * * *

(26 U.S.C. 1952 ed., Sec. 23(l)).

* * * * *

SEC. 3791. RULES AND REGULATIONS.

(a) *Authorization.*—

(1) *In general.*—Except as provided in section 1922(a), Cotton Futures, section 2599, Marihuana, section 2559, Narcotics, section 3176, Liquor, and section 1805, Silver, the Commissioner, with the approval of the Secretary, shall prescribe and publish all needful rules and regulations for the enforcment of this title.

(2) *In case of change in law.*—The Commissioner may make all such regulations, not otherwise provided for, as may have become necessary by reason of any alteration of law in relation to internal revenue.

(b) *Retroactivity of Regulations or Rulings.*—The Secretary, or the Commissioner with the approval of the Secretary, may prescribe the extent, if any, to which any ruling, regu-

lation, or Treasury Decision, relating to the internal revenue laws, shall be applied without retroactive effect.

(26 U.S.C. 1952 ed., Sec. 3791 (a) and (b)).

* * * * *

Treasury Regulations 111, promulgated October 26, 1943, under the Internal Revenue Code of 1939:

> SEC. 29.23(l)-1. *Depreciation.*—A reasonable allowance for the exhaustion, wear and tear, and obsolescence of property used in the trade or business, or treated under section 29.23(a)-15 as held by the taxpayer for the production of income, may be deducted from gross income. For convenience such an allowance will usually be referred to as depreciation, excluding from the term any idea of a mere reduction in market value not resulting from exhaustion, wear and tear, or obsolescence. The proper allowance for such depreciation is that amount which should be set aside for the taxable year in accordance with a reasonably consistent plan (not necessarily at a uniform rate), whereby the aggregate of the amounts so set aside, plus the salvage value, will, at the end of the useful life of the depreciable property, equal the cost or other basis of the property determined in accordance with section 113. Due regard must also be given to expenditures for current upkeep. * * *
>
> SEC. 29.23(l)-2. *Depreciable Property.*—The necessity for a depreciation allowance arises from the fact that certain property used in the business, or treated under section 29.23(a)-15 as held by the taxpayer for the production of income, gradually approaches a point where its usefulness is exhausted. The allowance should be confined to property of this nature. In the case of tangible property, it applies to that which is subject to wear and tear, to decay or decline from natural causes, to exhaustion, and to obsolescence due to the normal progress of the art, as where machinery or other property

must be replaced by a new invention, or due to the inadequacy of the property to the growing needs of the business. It does not apply to inventories or to stock in trade, or to land apart from the improvements or physical development added to it. It does not apply to bodies of minerals which through the process of removal suffer depletion, other provisions for this being made in the Internal Revenue Code. (See sections 23(m) and 114.) Property kept in repair may, nevertheless, be the subject of a depreciation allowance. (See section 29.23(a)-4.) The deduction of an allowance for depreciation is limited to property used in the taxpayer's trade or business, or treated under section 29.23(a)-15 as held by the taxpayer for the production of income. No such allowance may be made in respect of automobiles or other vehicles used solely for pleasure, a building used by the taxpayer solely as his residence, or in respect of furniture or furnishings therein, personal effects, or clothing; but properties and costumes used exclusively in a business, such as a theatrical business, may be the subject of a depreciation allowance.

SEC. 29.23(l)-4. *Capital Sum Recoverable Through Depreciation Allowances.*—The capital sum to be replaced by depreciation allowances is the cost or other basis of the property in respect of which the allowance is made. (See sections 113(a) and 114). To this amount should be added from time to time the cost of improvements, additions, and betterments, and from it should be deducted from time to time the amount of any definite loss or damage sustained by the property through casualty, as distinguished from the gradual exhaustion of its utility which is the basis of the depreciation allowance. (See section 113(b).) * * *

SEC. 29.23(l)-5. *Method of Computing Depreciation Allowance.*—The capital sum to be recovered shall be charged off over the useful

life of the property, either in equal annual installments or in accordance with any other recognized trade practice, such as an apportionment of the capital sum over units of production. Whatever plan or method of apportionment is adopted must be reasonable and must have due regard to operating conditions during the taxable period. The reasonableness of any claim for depreciation shall be determined upon the conditions known to exist at the end of the period for which the return is made. If the cost or other basis of the property has been recovered through depreciation or other allowances no further deduction for depreciation shall be allowed. The deduction for depreciation in respect of any depreciable property for any taxable year shall be limited to such ratable amount as may reasonably be considered necessary to recover during the remaining useful life of the property the unrecovered cost or other basis. The burden of proof will rest upon the taxpayer to sustain the deduction claimed. Therefore, taxpayers must furnish full and complete information with respect to the cost or other basis of the assets in respect of which depreciation is claimed, their age, condition, and remaining useful life, the portion of their cost or other basis which has been recovered through depreciation allowances for prior taxable years, and such other information as the Commissioner may require in substantiation of the deduction claimed.

A taxpayer is not permitted under the law to take advantage in later years of his prior failure to take any depreciation allowance or of his action in taking an allowance plainly inadequate under the known facts in prior years. * * *

* * * * *

APPENDIX B

Internal Revenue Code of 1954:

SEC. 167. DEPRECIATION.

(a) *General Rule.*—There shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—

(1) of property used in the trade or business, or

(2) of property held for the production of income.

(b) *Use of Certain Methods and Rates.*—For taxable years ending after December 31, 1953, the term "reasonable allowance" as used in subsection (a) shall include (but shall not be limited to) an allowance computed in accordance with regulations prescribed by the Secretary or his delegate, under any of the following methods:

(1) the straight line method,

(2) the declining balance method, using a rate not exceeding twice the rate which would have been used had the annual allowance been computed under the method described in paragraph (1),

(3) the sum of the years-digits method, and

(4) any other consistent method productive of an annual allowance which, when added to all allowances for the period commencing with the taxpayer's use of the property and including the taxable year, does not, during the first two-thirds of the useful life of the property, exceed the total of such allowances which would have been used had

such allowances been computed under the method described in paragraph (2).

Nothing in this subsection shall be construed to limit or reduce an allowance otherwise allowable under subsection (a).

(c) *Limitations on Use of Certain Methods and Rates.*—Paragraphs (2), (3), and (4) of subsection (b) shall apply only in the case of property (other than intangible property) described in subsection (a) with a useful life of 3 years or more—

* * * * * *

(f) *Basis for Depreciation.*—The basis on which exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the adjusted basis provided in section 1011 for the purpose of determining the gain on the sale or other disposition of such property.

* * * * *

(26 U.S.C. 1958 ed., Sec. 167 (a), (b), (c) and (f).)

* * * * *

SEC. 7805. RULES AND REGULATIONS.

(a) *Authorization.*—Except where such authority is expressly given by this title to any person other than an officer or employee of the Treasury Department, the Secretary or his delegate shall prescribe all needful rules and regulations for the enforcement of this title, including all rules and regulations as may be necessary by reason of any alteration of law in relation to internal revenue.

(b) *Retroactivity of Regulations or Rulings.*—The Secretary or his delegate may prescribe the extent, if any, to which any ruling or regulation, relating to the internal revenue laws, shall be applied without retroactive effect.

* * * * *

(26 U.S.C. 1958 ed., Sec. 7805 (a) and (b).)

Treasury Regulations on Income Tax (1954 Code):

SEC. 1.167(a)-1. *Depreciation in general.*—

(a) *Reasonable allowance.* Section 167(a) provides that a reasonable allowance for the exhaustion, wear and tear, and obsolescence of property used in the trade or business or of property held by the taxpayer for the production of income shall be allowed as a depreciation deduction. The allowance is that amount which should be set aside for the taxable year in accordance with a reasonable consistent plan (not necessarily at a uniform rate), so that the aggregate of the amounts set aside, plus the salvage value, will, at the end of the estimated useful life of the depreciable property, equal the cost or other basis of the property as provided in section 167(f) and § 1.167(f)-1. An asset shall not be depreciated below a reasonable salvage value under any method of computing depreciation. See paragraph (c) below for definition of salvage. The allowance shall not reflect amounts representing a mere reduction in market value.

(b) *Useful life.* For the purpose of section 167 the estimated useful life of an asset is not necessarily the useful life inherent in the asset but is the period over which the asset may reasonably be expected to be useful to the taxpayer in his trade or business or in the production of his income. This period shall be determined by reference to his experience with similar property taking into account present conditions and probable future developments. Some of the factor to be considered in determining this period are (1) wear and tear and decay or decline from natural causes, (2) the normal progress of the art, economic changes, inventions, and current developments within the industry and the taxpayer's trade or business, (3) the climatic and other local conditions peculiar to the taxpayer's trade or business, and (4) the

taxpayer's policy as to repairs, renewals, and replacements. Salvage value is not a factor for the purpose of determining useful life. If the taxpayer's experience is inadequate, the general experience in the industry may be used until such time as the taxpayer's own experience forms an adequate basis for making the determination. The estimated remaining useful life may be subject to modification by reason of conditions known to exist at the end of the taxable year and shall be redetermined when necessary regardless of the method of computing depreciation. However, estimated remaining useful life shall be redetermined only when the change in the useful life is significant and there is a clear and convincing basis for the redetermination. For rules covering agreements with respect to useful life, see section 167(d) and § 1.167(d)-1.

(c) *Salvage.* Salvage value is the amount (determined at the time of acquisition) which is estimated will be realizable upon sale or other disposition of an asset when it is no longer useful in the taxpayer's trade or business or in the production of his income and is to be retired from service by the taxpayer. Salvage value shall not be changed at any time after the determination made at the time of acquisition merely because of changes in price levels. However, if there is a redetermination of useful life under the rules of paragraph (b), salvage value may be redetermined based upon facts known at the time of such redetermination of useful life. Salvage, when reduced by the cost of removal, is referred to as net salvage. The time at which an asset is retired from service may vary according to the policy of the taxpayer. If the taxpayer's policy is to dispose of assets which are still in good operating condition, the salvage value may represent a relatively large proportion of the original basis of the asset. How-

ever, if the taxpayer customarily uses an asset until its inherent useful life has been substantially exhausted, salvage value may represent no more than junk value. Salvage value must be taken into account in determining the depreciation deduction either by a reduction of the amount subject to depreciation or by a reduction in the rate of depreciation, but in no event shall an asset (or an account) be depreciated below a reasonable salvage value. See, however, § 1.167(b)-2(a) for the treatment of salvage under the declining balance method. The taxpayer may use either salvage or net salvage in determining depreciation allowances but such practice must be consistently followed and the treatment of the costs of removal must be consistent with the practice adopted. For specific treatment of salvage value see §§ 1.167 (b)-1, 2, and 3. When an asset is retired or disposed of, appropriate adjustments shall be made in the asset and depreciation reserve accounts. For example, the amount of the salvage adjusted for the costs of removal may be credited to the depreciation reserve.

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SEC. 1.167(b)-0. *Methods of computing depreciation.*—

(a) *In general.* Any reasonable and consistently applied method of computing depreciation may be used or continued in use under section 167. Regardless of the method used in computing depreciation, deductions for depreciation shall not exceed such amounts as may be necessary to recover the unrecovered cost or other basis less salvage during the remaining useful life of the property. * * *

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SEC. 1.167(b)-1. *Straight line method.*—

(a) *Application of method.* Under the straight line method the cost or other basis of the property less its estimated salvage value is deductible in equal annual amounts over the

period of the estimated useful life of the property. The allowance for depreciation for the taxable year is determined by dividing the adjusted basis of the property at the beginning of the taxable year, less salvage value, by the remaining useful life of the property at such time. For convenience, the allowance so determined may be reduced to a percentage or fraction. The straight line method may be used in determining a reasonable allowance for depreciation for any property which is subject to depreciation under section 167 and it shall be used in all cases where the taxpayer has not adopted a different acceptable method with respect to such property.

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Treasury Regulations 103, promulgated January 29, 1940, under the Internal Revenue Code of 1939:

SEC. 19.23(l)-1. *Depreciation.*—A reasonable allowance for the exhaustion, wear and tear, and obsolescence of property used in the trade or business may be deducted from gross income. For convenience such an allowance will usually be referred to as depreciation, excluding from the term any idea of a mere reduction in market value not resulting from exhaustion, wear and tear, or obsolescence. The proper allowance for such depreciation of any property used in the trade or business is that amount which should be set aside for the taxable year in accordance with a reasonably consistent plan (not necessarily at a uniform rate), whereby the aggregate of the amounts so set aside, plus the salvage value, will, at the end of the useful life of the property in the business, equal the cost or other basis of the property determined in accordance with section 113. * * *

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